Social Investment Tax Relief

Keep it small and local

Individuals can now get tax breaks for investment in small social enterprises. Helen Elliott explains the idea behind social investment tax relief and how it works.

Social investment tax relief (SITR) is a new relief for income tax and capital gains tax (CGT) introduced by the Finance Act 2014. The objective is to encourage individual investment in small social enterprises. SITR provides a very generous 30% income tax deduction for the amount invested and is closely modelled on the enterprise investment scheme (EIS).

The broad premise behind all of the 'risk capital' schemes (EIS, seed enterprise investment scheme (SEIS), venture capital trusts (VCT), community investment tax relief (CITR) and now SITR) is that there is a market failure in the flow of capital to small businesses because of the specific risk for investors associated with small unlisted businesses. The government's intention is to compensate for that risk using-investor tax breaks.

What is a social enterprise?

Social enterprises are businesses that trade partly or wholly for social purposes. The social mission is usually enshrined in the governing documents together with a requirement to reinvest a percentage of profits back into the business or the social purpose. Oft-quoted social enterprises are the Big Issue, the Eden Project and Jamie Oliver's restaurant Fifteen.

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Social enterprises can now be found in many sectors of the economy, including retail, catering, manufacturing, management services, Fairtrade products, printing and design, recycling, translation, and IT services. Local communities sometimes set up a social enterprise to maintain facilities or services they see as important, for example a village post office, a local library or a leisure facility.

The government considers the existing EIS, VCT and SEIS schemes to have been successful. In the last 20 years EIS and VCT have generated approximately £16bn, benefiting over 20,000 small businesses. However, though some social enterprises benefit from these schemes, many do not, either because they do not issue shares or because the existing EIS/VCT/SEIS model does not work so well for social enterprises.

Research in 2011 estimated that about £165m of social investments were made in 2010 in the UK. The government's aspiration is to grow that, so it is measured in billions rather than millions, and to make the UK a world leader in social investment.

SITR is just one part of a package of measures designed to support and grow the social enterprise sector. Other parallel measures include:

- Big Society Capital, a social enterprise investor, set up with £400m from the dormant bank account fund to support social investment finance intermediaries (si-fis) who attract social investments and channel them to the social sector
- Social impact bonds (SIBs), a new investment product designed as a way to fund the achievement of quantifiable social outcomes. If (and only if) the social targets are achieved the bond holder is paid the stated return. Investments in SIBs are eligible for SITR.
- A pooled vehicle for social investment, based on the VCT
- A review of legislation to reduce barriers to social investment. This has included a recommendation by the Law Commission that charities are given an explicit power to make social investments.

SITR key features

SITR is structured along the same lines as the EIS though (unlike EIS) it is not limited to equity investment. The details are in Schs 11 and 12, FA 2014. The relief is available for investments made on or after 6 April 2014.

Investor tax reliefs

- Income tax relief takes the form of a deduction from the investor's income tax liability. It is set at 30% of the amount invested, capped at £1m of qualifying investment per investor per tax year.
- Equity investments attract share loss relief and losses on SITR eligible shares are excluded from the tax reliefs cap introduced in Finance Act 2013

- Any capital gain on disposal or redemption is exempt from CGT and there is a CGT holdover relief for gains invested in qualifying social investments
- There is no tax relief on dividends or interest payments
- For all reliefs, the investment must be held for a minimum of three years. If disposed of before this, any reliefs are clawed back.

Qualifying investors

- An investor must be an individual
- They cannot be an employee, partner, trustee or remunerated director of the social enterprise or any of its subsidiaries. The block also extends to associates (spouse, civil partner, ancestor, lineal descendant, business partners, settlement trustees, etc.) and some remunerated directors of ‘linked companies’.
- The investor must not control the social enterprise or any of its subsidiaries and cannot directly or indirectly possess or be entitled to acquire more than 30% of the share capital or loan capital or voting power of the social enterprise or any of its subsidiaries
- They cannot be a person acting in collusion with a non-qualifying investor

Qualifying investment

- The investment must be made between 6 April 2014 and 5 April 2019, though the Treasury may by order substitute a later end date
- It cannot also obtain relief under EIS, SEIS or CITR
- The investment must be in in the lowest rank of equity or debt. Debt must be unsecured and the return must not exceed a commercial rate of return
- Initially, indirect investment will only be allowed via an EIS-type nominee scheme though a VCT-like structure is likely to follow
- All investments must be approved in advance by the HMRC Small Company Enterprise Centre (SCEC). This unit also manages the EIS, SEIS and VCT schemes. The SCEC decides if a social enterprise and an investment qualify, and is responsible for monitoring social enterprises to ensure that they continue to meet the requirements of the scheme.

Investee: legal form

The government has chosen to restrict SITR to investments in four types of qualifying social enterprise but has given the Treasury power to extend the list:

- A community interest company (CIC). A CIC is a share or guarantee company that is subject to an asset lock and a dividend cap. Registration of a company as a CIC has to be approved by the CIC Regulator who also has a continuing monitoring and enforcement role.

- A community benefit society. This is a society that is registered under the Co-operative and Community Benefit Societies Act 2014 and carries on a business for the benefit of the community. The FSA is the regulator for Community Benefit Societies.
- A charity for tax purposes (including charitable trusts), as set out in Sch 6, Finance Act 2010. Charities have a variety of regulators.
- An 'accredited social impact contractor'. This is a share-limited company that is established for the purposes of carrying out a social impact contract, has entered into such a contract and is accredited by the Minister for the Cabinet Office

Investee: size, investment cap and control

- The social enterprise must have fewer than 500 full-time or equivalent employees and no more than £15m in gross assets immediately before the investment and £16m immediately after. If the social enterprise is the parent of a group, these figures apply to the entire group.
- The social enterprise cannot be or about to become a quoted company, nor can it be a subsidiary of a quoted company
- Investees are subject to an entity investment cap, from all SITR investors, of €344,827 (approximately £250,000) per social enterprise, reduced by any other tax relief or state aid received, but increased to £5m per tax year and £15m overall from 6 April 2015 subject to EC state aid approval
- The social enterprise must not be listed on a recognised stock exchange and there must be no arrangements for it to become so listed
- The social enterprise must not be a subsidiary of a company, or be under the control of a company, or under the control of a company and a person connected with that company, without being a subsidiary of the company
- The social enterprise must not control (whether on its own or together with any person connected with it) any company which is not a qualifying subsidiary of the social enterprise

Investee: qualifying trade

The social enterprise must carry on or be about to commence a qualifying trade and the investment must be used in that trade within two years. If the social enterprise is not a charity then, ignoring incidental activities, the whole of its business must comprise qualifying trading activities.

A qualifying trade is one that is conducted on a commercial basis and with a view to the realisation of profits and is not an excluded trade. Excluded trades include:

- Dealing in land, in commodities or futures or in shares, securities or other financial instruments
- Banking, insurance and financial services
- Property development
- Fishery and aquaculture activities (covered by EC Regulation 104/2000)

- The primary production of agricultural products (as listed in Annex I to the EU Treaty). However from 6 April 2015 small-scale community farms and horticultural activities will become eligible
- Generation or export of electricity that receives a feed-in-tariff. However, from 6 April 2015 all community energy generation undertaken by qualifying organisations will be eligible for SITR at which point it will cease to be eligible for EIS, SEIS and VCTs. This will remove the current exceptions to the existing exclusions for EIS and SEIS for anaerobic digestion and hydroelectric power
- Road freight transport for hire or reward
- In certain situations, providing services or facilities for a business which carries on an excluded activity

First approved scheme

The first qualifying SITR scheme was announced in November 2014. This was FareShare South West, a Bristol-based social enterprise that diverts food industry waste to charities and provides training and employment opportunities. It received a loan of £70,000 from a SITR nominee scheme set up by si-fi company Resonance. Investors will receive interest at 5% per annum for three years and 7% per annum for up to three more years.

Recycling SITR loans

The inclusion of loans in SITR means that ‘recycling’, or obtaining income tax relief on the same amount multiple times, becomes relatively straightforward. Loans must be held for at least three years and any recycled investment must be made before the current backstop date of 5 April 2019, so a maximum of two cycles is currently possible, though the backstop date may be extended by a future government. But just two cycles would give an impressive 60% income tax deduction on a single recycled loan.

Effect on Gift Aid

The charity sector has expressed some concern that SITR will damage Gift Aid donations. Comparing a £100 Gift Aid donation to a £100 interest-free SITR loan (and ignoring the time value of money) shows that all levels of taxpayer are better off making a SITR loan than a Gift Aid donation, with basic rate taxpayers benefiting the most. The government also benefits where higher and additional rate taxpayers convert Gift Aid donations to loans, but not where basic rate taxpayers do so. The big losers are of course charities.

	Basic rate taxpayer £	Higher rate taxpayer £	Additional rate taxpayer £
Donor	+130	+105	+98.75
Charity	-125	-125	-125
Government	-5	+20	+26.25

Gift Aid donation of £100 v SITR loan of £100. Positive = loan better than Gift Aid, negative = loan worse than Gift Aid

The main users of the existing EIS, SEIS and VCT schemes are wealthy investors. The government sees this as appropriate, on the basis wealthy investors can deal with the risks involved. It seems likely that the appeal of SITR will also largely be to wealthy investors, though there is clearly scope for extension to basic rate taxpayers as a result of the social mission. From the figures in the table, the Treasury will presumably not be too unhappy if higher or additional rate taxpayers switch from Gift Aid to SITR.

However, it remains to be seen how SITR will affect Gift Aid. An immediate limitation for SITR is its complexity and strictly limited scope. In addition it is by no means obvious that gifts and investments necessarily compete with each other.

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